exchange interconnection, a relatively new area which both State and Federal regulatory authorities are just beginning to explore. It is quite another to say that such standards were intended to override existing State and Federal carrier access pricing policies, which have been the subject of over a decade of detailed regulatory development and review.

1. Effect on Federal Jurisdiction

If § 251(c)(2) applied to carrier access rates, then an IC could seek modifications of those rates either through negotiations leading to a voluntarily agreement (as described in § 252(a)), or through compulsory arbitration by a State commission under § 252(b).[29] In either case, the resulting terms and conditions are to be reviewed, and either approved or rejected, by the State commission.[30] The FCC would be involved in the review process only if the State commission fails to carry out its review responsibilities, and if the Commission as a result issues an order preempting the State commission's jurisdiction.[31] In short, the process of applying the § 251(c)(1) standard is committed to the parties and to State regulatory authorities, but not, except in very limited circumstances, to the Commission.

Under the ICs' interpretation, then, the combined effect of §§ 251 and 252 could be to effectively divest the Commission of its jurisdiction over the rates for interstate exchange access services. Since such services represent a significant fraction of a BOC's total interstate

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[29] A third alternative is for a BOC to "prepare and file with a State commission a statement of the terms and conditions that such company generally offers within that State to comply with the requirements of Section 251 and the regulations thereunder and the standards applicable under this section" (§ 252(f)(1)). Such a statement would be subject to review and approval by the State commission (§§ 252(f)(2)-(4)).

[30] § 252(e).

[31] § 252(e)(5).

revenues (and costs), such a divestiture could deprive the Commission of its power to ensure that the BOC's rates will enable it to recover its interstate revenue requirement, as determined through the separations/Federal-State Joint Board process.[32]

2. Effect on State Jurisdiction

Notwithstanding the State's authority over the process of implementing the § 251(c)(2) interconnection obligation, that authority must in general be exercised in a way that conforms to the substantive standards set by the section itself. For example, under § 252(c), a State commission resolving a compulsory arbitration under § 252(b) must "ensure that such resolution and conditions meet the requirements of Section 251, including the regulations prescribed by the Commission pursuant to section 251," and must also ensure that interconnection rates conform to the pricing standard of § 252(d). In reviewing a BOC Statement of Generally Available Terms under § 252(f), a State commission must determine whether the statement complies with § 251, with the regulations promulgated by the FCC thereunder, and with § 252(d).[33] Thus, an interpretation of the Act that applied §251(c) to carrier access charges would preempt State carrier access pricing policies that have been the subject of literally years of detailed consideration.[34] (The same, of course, would be true of federal access pricing policies.)

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[32] See § 410(c).

[33] § 252(f)(2).

[34] The absence of an intent to effect such a wholesale preemption of State policies is suggested by § 251(d)(3): "In prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that : (A) establishes access and interconnection obligations of local exchange carriers; (B) is consistent with the requirements of this section; and (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part." See also § 261(b) ("Nothing in this part shall be construed to prohibit any State

In New York, for example, the New York Public Service Commission ("NYPSC") spent several years addressing pricing issues relating to carrier access and toll services in Case 28425. In that proceeding, detailed cost manuals were developed and were approved by the NYPSC, cost studies were consulted, hearings were held, thousands of pages of testimony, briefs, and exhibits were submitted, and numerous orders addressing a variety of issues were issued by the NYPSC. Further consideration was given to carrier access rates in Case 92-C-0665, resulting in a substantial rate reduction in 1994. The issue was reopened once again in connection with the NYPSC's review of a proposed Performance Regulation Plan for New York Telephone Company; indeed carrier access rates were one of the principal issues addressed in that review process (which entailed lengthy evidentiary hearings held in late 1994). The Plan as ultimately approved by the NYPSC included various commitments relating to the reduction of interLATA and intraLATA access rates, as well as price-floor/imputation rules designed to maintain an appropriate relationship between access and toll rates. Mandated carrier access price reductions, as suggested by the ICs, could compromise the very foundations of that Plan.

IV. SECTION 251(c)(3) DOES NOT REQUIRE AN INCUMBENT LEC TO PROVIDE ACCESS TO NETWORK ELEMENTS SOLELY FOR THE PURPOSE OF ORIGINATING AND TERMINATING INTEREXCHANGE TOLL TRAFFIC.

Section 251(c)(3) imposes upon incumbent LECs the duty to provide:

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commission from enforcing regulations prescribed prior to the date of the enactment of the Telecommunications Act of 1996, or from prescribing regulations after such date of enactment, in fulfilling the requirements of this part, if such regulations are not inconsistent with the provisions of this part").

> "to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point ...."

The section does not impose any restrictions on the service that the requesting carrier can provision through the use of the unbundled network elements that it purchases from the incumbent LEC.[35] In particular, the section does not prevent a requesting carrier (e.g., an IC) from using unbundled network elements to originate or terminate interexchange traffic in conjunction with its offering of local exchange and exchange access service.

However, at the same time, the express language of §§ 251(g) and 251(i), as well as the legislative history and policy summarized in the previous section, make it clear that § 251(c)(3), like § 251(c)(2), was not intended to override or undermine the carrier access charge regimes that have been established by the Commission and by the states. Accordingly, while NYNEX agrees that unbundled network elements can be used by the requesting carrier to provide any telecommunications service that it wants (both local and long-distance, intrastate and interstate), an incumbent LEC cannot be required to provide access to network elements, such as the local loop, *solely* for the purpose of originating and terminating interexchange toll traffic.[36] In other words, a carrier that chooses to take a loop as an unbundled network element must take the entire functionality of the loop, i.e., the loop must be used to provide both local exchange and exchange access service. The loop cannot be used for the sole purpose of originating and terminating interexchange traffic.[37] As the Commission noted, under this interpretation the requesting carrier

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[35] See, NPRM, ¶ 166.

[36] NPRM ¶ 164.

[37] To the extent a carrier desires to use a loop for the sole purpose of originating and terminating interexchange traffic, the Commission's Expanded Interconnection Order

"could not, as a practical matter, purchase such access without having won over the local customer associated with the loop and providing that telephone exchange service to that customer (or arranging for others to provide it)."[38] This interpretation preserves the limitations on the scope of § 251(c)(3) that are imposed by §§ 251(i) and (g), and by the legislative history and considerations of statutory purpose discussed above.

V. SECTION 251(c)(2) APPLIES TO COMPETING CMRS PROVIDERS, BUT NOT TO NON-COMPETING NEIGHBORING LECs.

The Commission inquires whether interconnection requests by CMRS providers and by neighboring, non-competing LECs fall within the scope of Section 251(c)(2)(NPRM ¶¶ 166-171). As discussed above, that section governs the obligations of incumbent LECs to provide interconnection "for the transmission and routing of telephone exchange service and exchange access" within the incumbent LEC's service area. As shown below, the requests of CMRS providers for interconnection fall within the bounds of this section because they provide local exchange and exchange access service within the LEC's local exchange area for much of their traffic. The requests of neighboring, non-competing LECs do not.

A. Section 251(c)(2) Applies To CMRS Requests For Exchange Service And Exchange Access Within The LEC Exchange Area

To begin with the CMRS providers, the NPRM correctly notes that CMRS services fall within the statutory definition of "telecommunications service" under

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provides CAPs and ICs an unbundled loop called a voice grade Channel Termination for that purpose.

[38] Id.

Section 153(46), and that CMRS providers fall within the definition of "telecommunications carrier(s)" under Section 153(44) of the Act (NPRM ¶ 166). Therefore, the applicability of Section 251(c)(2) to CMRS providers depends on whether they seek interconnection for the purpose of providing "telephone exchange service and exchange access."

CMRS providers, other than one-way paging services,[39] in fact provide such telephone exchange service within the incumbent LEC's exchange area as a principal part of their business.[40] To the extent that they do, the obligations of incumbent LECs to "interconnect" subject to Section 251(c)(2) of the Act clearly apply.

The Commission has an ongoing inquiry in CC Docket No. 95-185[41] which is considering the relationship between Section 332(c) of the Act, as amended by the Omnibus Budget Reconciliation Act of 1993, and Sections 251 and 252 of the Act. As NYNEX noted in its comments in CC Docket No. 95-185, there is no conflict in these statutory provisions that would enable "the requesting carrier . . . to choose the provision under which to proceed"

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[39] Paging services are not designed currently to intercommunicate as part of interconnected networks. Instead, a LEC customer first terminates a call with the paging provider, and then that paging provider institutes a second message over its private network to its subscriber. In order to "intercommunicate," the paging subscriber must separately reach a station on the public switched network.

[40] "Part 22 licensees are common carriers generally engaged in the provision of local exchange telecommunications in conjunction with local telephone companies...." In the Matter of the Need to Promote Competition and Efficient Use of Spectrum For Radio Common Carrier Services, Memorandum Opinion and Order ("Competition Opinion"), 59 Rad. Reg. 2d 1275 at ¶ 12 (1986).

[41] In the Matter of Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, Notice of Proposed Rulemaking, CC Docket 95-185, FCC 95-505 (released January 11, 1996).

(NPRM ¶ 169). Under Section 332(c), this Commission has jurisdiction to preempt State regulations that serve as a "barrier to entry" or regulate the rates charged by CMRS providers.[42] With respect to LEC interconnection rates paid by CMRS providers, dual federal/state regulatory jurisdiction exists under Section 152 of the Act, as recognized in established Commission precedent.[43] Nothing in Section 332(c) enacted in 1993 removed state jurisdiction in this area:

> "[W]e note that Louisiana's regulation of the interconnection rates charged by landline telephone companies to CMRS providers appears to involve rate regulation only of the landline companies, not the CMRS providers, and thus does not appear to be circumscribed in any way by Section 332(c)(3)."[44]

This is confirmed by the principal State role established by Congress in 1996 for LEC interconnection rates in Sections 251 and 252.[45]

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[42] See Section 332(c) of the Act.

[43] The Commission itself could not have more explicitly stated this fundamental principle of law, than by its declaration in 1987 that:

"Although we find that we have plenary jurisdiction over the physical interconnections between cellular and landline carriers, the actual costs and charges for the physical interconnections of cellular systems are suited to dual intrastate and interstate regulation. Charges applicable to cellular interconnection are separable. As with telephone depreciation costs [at issue in Louisiana Pub. Serv. Comm'n v. FCC], it is possible to divide the actual interstate and intrastate costs of cellular interconnection. . . . Although we are not mandating a jurisdictional separations process for the cellular service unless it becomes necessary to do so, we emphasize that our jurisdiction is limited to the actual interstate cost of interconnection and ensuring that interconnection is provided for interstate service."

[44] In the Matter of the Need to Promote Competition and Efficient Use of Spectrum for Radio Common Carrier Services, Report No. CC-379, Declaratory Ruling, 2 FCC Rcd. 2910, 2912 (1987); Petition on Behalf of Louisiana Pub. Serv. Comm'n, 10 FCC Rcd 7898, 7908 (1995).

[45] The NPRM also inquires whether it would be sound policy for the Commission "to distinguish between telecommunications carriers on the basis of the technology they use" (NPRM ¶ 169). The inquiry itself presupposes the Commission's proper judgment that it is poor policy for it to favor, or disfavor, particular technologies. To do otherwise, will distort technology selection by carriers and the public based on an unbiased comparison of

B. Section 251(c)(2) Does Not Apply To The Requests Of Neighboring LECs That Are Not For The Offer Of Competing Local Exchange Service

The Commission observes that agreements between non-competing neighboring LECs might appear to fall within the "exchange access" provision of Section 251(c)(2)(NPRM ¶ 171). However, it concedes that Section 251 read "in context" relates to the provision of interconnection for competing carriers, not to arrangements between adjacent and coordinating carriers (Id.). In fact, the statute and the legislative history support this better view.

To begin, agreements between neighboring, non-competing LECs (frequently called independent telephone companies, hereafter "independent telcos") have historically been developed under Section 201 of the Communications Act. These agreements vary by state, but generally address the following: independent telco-billed intraLATA toll services; provisioning and maintenance of access services; private line services: interLATA and intraLATA billing services; intraLATA operator services; directory services; interstate "meet point" compensation agreements; SS7 and 800 database services; enhanced 911 services; and paging services. The contracts are typically designed to permit a rural independent telco to provide full service to end users in its exchange territory. Congress specifically continued the Commission's preexisting authority over such agreements under Section 201, stating in Section 251(i) that "[n]othing in

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technological capabilities and economics, comparative criteria which redound to the public interest. In the case of CMRS, however, the Congress enacted Section 332 which established a different regulatory jurisdiction for entry and rate regulation. Again, in the 1996 Act, Congress omitted these carriers from the definition of "local exchange carrier" which exempts them from certain obligations, Section 153(28). However, Congress has not distinguished CMRS providers with respect to LEC interconnection rates, and the Commission should not on its own provide distinctive treatment, (see e.g., discussion of "Bill-and-Keep" infra).

this section [251] shall be construed to limit or otherwise affect the Commission's authority under § 201."[46]

Further, there is no indication that Congress meant to disturb such agreements by the enactment of Section 251. Each of the independent telcos are themselves "incumbent LECs" with obligations under Section 251(c). However, the interconnection obligations required of "incumbent LECs" under Section 251(c)(2) are not owed to other incumbent LECs, but rather to "requesting telecommunications carriers" that seek to provide "telephone exchange service and exchange access," within the incumbent LEC's local exchange;[47] they do not extend to interconnection requests by independent telcos to enable such companies to provide local exchange and exchange access service within their own territory.[48]

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[46] The legislative history records that "[n]ew 251(i) makes clear the conferee's intent that the provisions of new Section 251 are in addition to, and in no way limit or affect, the Commission's existing authority regarding interconnection under Section 201 of the Communications Act." See H.R. Conference Report No. 104-458 ("Conference Report") (1996) at 123.

[47] See, Section 153 (47): "The term telephone exchange service" means (A) service within a telephone exchange, or within a connected system of telephone exchange within the same exchange area . . . ." (emphasis supplied).

[48] An "incumbent" is defined in § 251(h) as a local exchange carrier that "on the date of enactment" of the Act "provided telephone exchange service in such area," and on such date was deemed to be a member of the exchange carrier association.[48] 47 U.S.C. § 251(h). Both the larger LECs and the independent telcos fall squarely within the definition of "incumbent" local exchange carriers, providing service in their respective exchanges, and outside the scope of § 251(c) which is designed to promote competition between an incumbent and a requesting carrier within the same exchange. That Congress understood these independent telcos to be "incumbent local exchange carriers" is manifest from its further action to exempt certain rural carriers from incumbent LEC obligations. § 251(f).

The legislative history establishes that these independent telco agreements were never intended to fall within the scope of § 251(c). References to relevant House and Senate activities underscore the fact that § 251(c) addresses competition between incumbent LECs and "new entrants" within incumbent LEC exchanges. Thus, with respect to H.R. 1555, the legislative history records:

- "Section 242(a)(1) [of the House amendment] sets out the specific requirements of openness and accessibility that apply to LECs as competitors enter the local market and seek access to, and interconnection with, the incumbent's network facilities."[49]

- "Section 242(b)(1) [of the House amendment] describes the specific terms and conditions for interconnection, compensation, and equal access, which are integral to a competing provider seeking to offer local telephone services over its own facilities."[50]

Similarly, Senate Bill 652 was designed to allow "other parties to provide competitive service through interconnection with the LEC's facilities."[51]

Overall, the Conference committee agreed that "Section 101 of the conference agreement establishes a new "Part II" of title II of the Communications Act. Part II contains sections 251-261 of the Communications Act to create competitive communications markets."[52] Indeed, Part II itself is entitled "Development of Competitive Markets." As the Commission

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[49] Conference Report at 120. House § 242(b)(1) is generally reflected in § 251(c) of the Act (emphasis added).

[50] Conference Report at 120. House § 242(b)(1) is also generally reflected in § 251(c) of the Act (emphasis added).

[51] Congressional Record S7893 (daily ed. June 7, 1995)(statement of Senator Pressler) (emphasis added).

[52] Conference Report at 117.

properly recognized in the NPRM, there is no competition between incumbent LECs and independent telcos and § 251(c)(2) does not apply (NPRM ¶ 171).[53]

This is not to say that independent telcos cannot claim the rights of Section 251(c)(2) should they decide to compete in another LECs local franchise area (NPRM ¶ 171). In fact, they would have that right. However, to the extent an independent telco requests only the interconnection necessary to provide its own separate exchange service or exchange access, such requests and interconnection agreements do not fall properly within Section 251(c)(2). And, as discussed above, that conclusion does not impair the competition in local exchange markets that both Congress and this Commission intend to promote.[54]

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[53] The Commission further notes that if such agreements are governed by Section 251(c)(2), they should be made public and the terms and conditions made available to other carriers (NPRM § 170). However, as discussed above, an incumbent LEC's obligation under § 252 to negotiate an interconnection agreement arises specifically "pursuant to § 251." See § 252(a) (1). To the extent, therefore, that the agreement does not constitute an "interconnection" agreement "pursuant to § 251," the incumbent is not obligated "to negotiate ... in accordance with § 252" (see § 251(c) (1)) and the agreement, if any, need not be submitted to the state for approval under subsection (e). See Senate Report No. 104-23, dated March 30, 1995, at 21: "Subsection 251(c) [of S.652] requires that any interconnection agreement under § 251 must be submitted to the State for approval" (emphasis added). (Senate Bill § 251(c) was the predecessor of enacted § 252(c)). Inasmuch as only an agreement made pursuant to § 251 need be submitted for state approval, the nondiscrimination requirements of § 252(i) would similarly not apply.

[54] In fact, a misinterpretation of Section 251 treating these independent telcos as incumbent LECs with existing "Section 251" interconnection agreements would frustrate the Congressional purpose of promoting "infrastructure sharing" and "cooperation," rather than competition, among these entities and the larger LECs to advance the public interest. See Section 259.

VI. COMPETING CARRIERS SHOULD NOT BE ALLOWED TO REQUEST UNBUNDLED ELEMENTS TO AVOID PAYING FOR A SERVICE THAT IS OFFERED FOR RESALE

The Act contains separate and distinct obligations regarding (i) the resale of services and (ii) access to unbundled network elements. Under the Act, deliberately different pricing methodologies apply to services offered for resale and network elements provided on an unbundled basis. As the Commission acknowledges in the NPRM, a potential for conflict of these obligations arises where services offered for resale are made up of various network elements.[55]

The legislative history of the Act clearly demonstrates that it was not Congress' intent to require the LECs to subsidize their competitors' entry into the local exchange market, or to have local rates skyrocket. The establishment of the separate "resale" and "unbundling" mechanisms, with their different pricing standards, supports this Congressional intent. Under the resale approach, the discount to competitors is based solely on the net avoided costs of resale. Therefore, to the extent existing rates are established to support low priced basic services, the requirement to allow resale at net avoided costs should not affect the LECs' ability to maintain existing basic exchange service rates.

With regard to unbundling, the requirement to make available existing unbundled elements (facilities and equipment) at the true cost of those facilities, including a reasonable profit, should similarly have little impact on the continuation of existing rates since the LEC will be recovering its costs of the facilities which will be used by the new entrant to serve customers

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[55] NPRM ¶¶ 84-85.

previously served by the LEC. However, just the opposite impact will likely occur if new entrants can in effect recreate existing services by purchasing and combining unbundled elements.

To the extent new entrants can choose to use only unbundled elements for what amounts to resale (i.e., they provide none of the facilities to offer exchange and exchange access services), they will most certainly always choose the lower cost option to undercut current local prices. These new providers will thus end up in the anomalous situation of being able to provide service using nothing but incumbent LEC facilities, at prices well below those that can be charged by the LEC. This will occur not because of any efficiencies brought to the marketplace by these new entrants, but rather only as the result of State-mandated pricing policies designed to support below cost basic exchange services. The result will be the inability of the LEC to continue to support these rates and/or the inability to financially support local network maintenance and development.

NYNEX accordingly proposes that the Commission prohibit interconnectors from obtaining all of the network elements that comprise a LEC resale service and then combining these elements to form the service offered by the LEC for resale. A competitor should be required to provide a minimum of one of the component network elements that comprise a LEC resale service and combine that element with the unbundled network elements provided by the LEC.

A. Commission Rules Should Provide That Resale Obligations Take Precedence Over The Unbundling Requirements Or, Alternatively, Prevent Arbitrage By Interconnectors Through The "Mixing And Matching" Of Services Offered For Resale And Unbundled Network Elements.

(1) The History Of The Resale And Unbundling Requirements In The House And Senate

As originally introduced in the House,[56] H.R. 1555 did not limit resale to services and unbundled access to network elements. Unbundling requirements applied to services, elements, features, functions, and capabilities. Resale requirements applied -- on both a bundled and an unbundled basis -- to services, elements, features, functions, and capabilities. H.R. 1555 also failed to establish different pricing methodologies for unbundling and for resale. Users of unbundled services, elements, features, functions, and capabilities were required to bear the costs of providing unbundled offerings. A separate pricing methodology for resale on a bundled basis was not addressed.[57]

The version of H.R. 1555 subsequently reported by the House Subcommittee on Telecommunications and Finance had been amended, however, to require services, elements, features, functions and capabilities to be offered for resale "at economically feasible rates to the reseller, recognizing pricing structures for telephone exchange service in such State."[58] Although the pricing methodology established for resale created controversy in the House,[59] the

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[56] The Act was originally introduced in the House as H.R. 1555, on May 3, 1995.

[57] H.R. 1555, as introduced, §§242(a)(2) and (3) and 242(b)(4)(C).

[58] Text of H.R. 1555, as reported by the Subcommittee on Telecommunications and Finance (Committee Print) (May 20, 1995), §242(a)(3).

[59] See Tauzin Amendment, proposed May 24, 1995, to § 242(a)(3) of H.R. 1555, which would have required resale "at just and reasonable rates to the reseller."

methodology was included in the House Committee on Commerce Report 104-204, Part I.[60] The House Report recognized resale as a vehicle to create immediate opportunities to compete "[i]n markets where a facilities-based competitor is not likely to emerge in the near term ...." The House Report stated the specific intent to set resale rates "by taking into account the rate at which local service is tariffed in a particular State." The resale rates were to be determined in this manner to protect the subsidies of local dialtone service and universal service:

> "Section 242(a)(3) imposes the duty to offer resale at economically feasible rates to the reseller. This duty is important in order for non-facilities-based carriers to have an opportunity to compete in the local exchange market, in the same way that is was critical initially for the early development of competition in the long distance market. In markets where a facilities-based competitor is not likely to emerge in the near term, the Committee believes that it is imperative that meaningful resale opportunities are available for competition in the local exchange
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> Nonetheless, in determining the resale rate, it is the Committee's intent that there be a recognition of pricing structures for telephone exchange service in the State. In other words, determining the resale rates should be accomplished by taking into account the rate at which local service is tariffed in a particular State. The rate should reflect whether, and to what extent, the local dialtone service is subsidized by other services, such as toll service, long distance access, subsidized through the pricing for other features, such as call forwarding and call waiting, or subsidized through explicit subsidies from a universal service fund."[61]

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[60] House Committee on Commerce Report 104-204, Part I (July 24, 1995) (the "House Report").

[61] House Report, p. 72 (emphasis added). The House Report also included a letter voicing concerns regarding local telephone service and universal service, which referred to the requirement to offer resale at rates "economically feasible to the reseller" as the "most pernicious" restriction in H.R. 1555. The letter observed that local telephone service is heavily subsidized, and decried a resale pricing provision that would require prices to resellers that are further discounted. It stated that any discount that exceeded the cost of marketing, and of billing and collection, would constitute an unwarranted subsidy to resellers

The concern for the protection of subsidies of local telephone service and universal service led ultimately to the amendment of H.R. 1555 to require resale at "wholesale rates," to be determined based on retail rates less avoided costs.[62] This amendment was hailed as correcting a provision that would have required LECs to subsidize their competitors and "caused local rates to skyrocket for the household user."[63] This "top down" pricing methodology for resale was included in H.R. 1555, as passed by the House.[64]

In the Senate, similar views and concerns regarding resale shaped S. 652. The Senate recognized resale as the way to enable quick entry into the market by competitors that do not have their own telecommunications facilities. Like the House, the Senate did not distinguish two wholesale vehicles by limiting resale to services and unbundled access to network elements, but the resale pricing provisions were a source of controversy and the object of special concern. In S. 652, as introduced, resale of unbundled "telecommunications services and network functions" was required. It appears that a cost-based pricing methodology was to apply to both unbundling and resale, subject to certain rights of the State in the case of universal service.[65] Unlike the House, however, the Senate was not able to resolve the controversy surrounding the issue of resale pricing.

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and jeopardize universal service. See Letter signed by Congressmen Dingell, Tauzin, Boucher and Stupak, House Report, p. 209.

62 Bliley Amendment, proposed August 4, 1995.

63 Congressional Record - House, August 4, 1995. H8452.

64 H.R. 1555, §242(a)(2) and (3), as passed by the House in August, 1995.

65 S. 652 as Introduced and as Contained in the Report of the Committee on Commerce, Science, and Transportation (March 30, 1995), §251(b)(1), (2) and (7) and §251(d)(6).

In the Senate, resale was cited as a vehicle for competitors that do not have their own telecommunications facilities to "jump-start local competition:"

> "If our Nation's experience with competitive long distance service is any model ... resale will be the essential first step in developing competitive local exchange markets. Given the enormous cost of building sophisticated communications networks throughout the country, local exchange competition will never have a chance to develop if competitors have to start by building networks that are comparable to the vast and well-established Bell networks. For this reason, affordable resale opportunities are the key to stimulating local competition."[66]

There was clearly a desire to create opportunities that afforded resellers adequate margins for profit, which reflected savings realized by incumbent LECs by selling on a wholesale basis.[67] Equally clear, however, was the intent that resale prices be set to protect existing subsidies. Thus, although a proposed amendment would have required resale offerings to be based on "cost," it was expressly stated that subsidies of residential retail rates would be "counted towards the recovery of costs in setting resale prices."[68] The proposed amendment was subsequently withdrawn with the statement that the issue of resale pricing would be resolved in the conference reconciling H.R. 1555 and S. 652.[69]

(2) The Two Distinct Competitive Vehicles, With Different Pricing Methodologies, Created By The Act

Congress ultimately resolved the issue of resale pricing by adopting the resale pricing methodology proposed in H.R. 1555, which provided for a wholesale price, determined

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66 Congressional Record - Senate, June 14, 1995, S8369 (Senator Inouye).

67 Congressional Record - Senate, June 14, 1995, S8369 (Senator Inouye).

68 Congressional Record-Senate, June 14, 1995, S8369.

69 Congressional Record - Senate, June 14, 1995, S8369 and S8400, June 15, 1995, S8438.

on the basis of retail price, less avoided costs. As shown above, the development of this methodology was driven by the intent to provide a wholesale vehicle to promote competition by non-facilities based competitors, while protecting local telephone service rates and universal service.

The Act also resolved the relationship of resale and unbundling by the creation of two distinct competitive tracks, with a different pricing methodology applicable to each. First, the Act defines and distinguishes "telecommunications services" and "network elements." A telecommunications service is the offering of telecommunications for a fee directly to the public; a network element is a facility or functionality used by another facilities-based network provider to offer telecommunications service.

Second, the Act requires that telecommunications services and network elements each be offered in distinctly different ways. Telecommunications services are to be offered for resale.[70] Incumbent LECs are required to provide access to network elements on an unbundled basis.

Third, markedly different pricing methodologies apply to resale of services and unbundled network elements. A "top down" approach applies to resale of services, while a "bottom up" approach applies to unbundled network elements. The Act requires an incumbent LEC to offer services for resale at "wholesale rates," determined on the basis of retail rates less

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[70] The resale requirement is limited to services that are provided to customers that are not telecommunications carriers. Thus, there is no obligation on an incumbent LEC's part to allow for resale of its access services provided to carriers.

avoided costs.[71] By contrast, charges for unbundled network elements are to be based on the cost of providing the network element and may include a reasonable profit.[72]

The legislative history and the express provisions of the Act, creating two competitive vehicles, show that the Act's resale obligations take precedence over the unbundling requirements. The resale pricing methodology is in sharp contrast to the pricing methodology that Congress chose to apply to unbundled network elements, which provides for prices based on cost, and including a reasonable profit. In fact, the resale pricing provisions are a clear rejection of cost-based rates for resale services. This is consistent with the history of other provisions of the Act, which shows that Congress did not intend §§251 and 252 as catalysts for rate rebalancing.[73] Rather, the intent was to use resale to "jump-start" competition, while protecting local telephone service and universal service through the "top down" resale pricing methodology of retail price, less avoided costs. This objective will be defeated if the Commission fails to

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[71] See § 251(c)(4) and § 252(d)(3).

[72] See § 252(d)(1).

[73] Sections 251 and 252 do not contain any provisions that would require rebalancing of rates. This is consistent with the legislative history, which evidences a rejection of rate rebalancing, or an intent to defer that issue to a consideration of universal service as prescribed in §254. Section 248 of H.R. 1555 contained provisions which would have minimized residential price increases; §301 of S. 652 included a provision related to price regulation and consumer protection which, like H.R. 1555 §248, is inconsistent with the rebalancing of rates through the closer alignment of prices with costs. Although these provisions were not included in the Act, they are indicative of Congress' deeper concern to protect consumers from increased rates than to achieve cost-based rates at the expense of existing subsidies. Notwithstanding the fact that charges for interexchange access contain large subsidies, the final legislation does not include provisions which were in both the House and Senate bills that would have required BOCs to provide exchange access at cost-based rates. See , H.R. 1555 § 246(i)(3) and S. 652 § 252(e)(3). In fact, as discussed above, § 251(g) of the Act expressly preserves the status quo with regard to charges for interexchange access.

adopt rules that prevent the Act's resale provisions from being subsumed by the unbundling requirements.

NYNEX disagrees with the Commission's tentative conclusion that the last sentence of §251(c)(3) allows a requesting carrier to order and combine (or require the LEC to combine) all of the network elements needed to duplicate a service offered by the LEC for resale (for example, the loop and the port, if combined by an incumbent LEC, would be functionally equivalent to local exchange service).[74] This sentence can only be read one way to be consistent with both the letter and spirit of the Act. It is intended to make clear the right of partial facilities-based competitors to combine their network elements with the network elements of an incumbent LEC.

In fact, acceptance of the argument that the last sentence in Section 251(c)(3) creates yet a third competitive vehicle would have the effect of allowing unbundling provisions to subsume resale provisions. Given the context and the legislative history, this sentence cannot be construed to permit an interconnector to obtain, at cost-based prices, all of the network elements that comprise a LEC resale service and then combine these network elements (or require the incumbent LEC to do so)[75] to form the service offered by the LEC for resale. Indeed, the features and capabilities provided by a network element should not be made available without

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[74] NPRM, ¶ 85. This requirement did not appear in H.R. 1555 or S. 652, nor is it discussed in the Joint Explanatory Statement of the Committee of Conference.

[75] Clearly, there is no basis in the express language of the Act to argue that incumbent LECs have to reassemble network elements. Section 251(c)(3) only requires an incumbent LEC to provide unbundled network elements to allow "requesting carriers to combine such elements in order to provide ... telecommunications service" (emphasis supplied).

purchasing the underlying network element. The Commission should require a competitor to provide a minimum of one of the component network elements that comprise a LEC resale service and combine that element with the unbundled elements provided by a LEC.

(3) The Commission Should Prevent The Evasion Of The Resale Requirements Of The Act And Arbitrage Through Mixing and Matching

The Commission should at the very least prohibit a competitor from engaging in arbitrage by "mixing and matching" services offered by the LEC for resale with LEC unbundled network elements to provide a particular service to the competitor's customer. For example, a competitor should not be allowed to obtain resold local exchange service and ask for vertical features at cost-based rates.

The NPRM evidences a notable -- and appropriate -- concern for economic, as well as legal issues. Consistent with that concern, the Commission should address the potential for arbitrage inadvertently created by the two competitive vehicles, and adopt rules to prevent it.[76] The Act was intended to promote local competition, not to prevent incumbent LECs from earning a reasonable profit.[77] Both -- to say nothing of a fine-drawn statutory scheme -- would be undermined by arbitrage by requesting parties and/or resellers.

Rules prohibiting "mixing and matching" are completely consistent with the vision Congress has of competition in the local exchange market. Congress provided two

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[76] The potential for arbitrage would be created by the ability of a CLEC to purchase on a resale basis those services offered by a LEC to the public at less than cost while purchasing on an unbundled basis (at cost-based prices) facilities and functionalities used to provide services offered to the public at above-cost prices.

[77] See NPRM ¶11.

different competitive vehicles to serve the needs of two categories of competitors. Resale enables competitors who do not have their own facilities to compete by using resold service to develop and offer services to its customers. Nothing precludes competitors that obtain incumbent LEC resale services from using these services to offer innovative services and pricing packages to their customers. Unbundled network elements allow facilities-based competitors to supplement their own networks with unbundled network elements obtained from the incumbent LEC.

Nothing in the Act does or should preclude a single entity from pursuing a competitive strategy using both resold services and unbundled network elements. However, with regard to the particular service it provides to any one of its customers, the competitor will be either a reseller or a facilities-based competitor. The Commission's rules should thus prohibit a competitor from "mixing and matching" services for resale obtained under § 251(c)(4) and unbundled network elements obtained under § 251(c)(3) to serve a single customer. The two competitive vehicles were intended to meet different strategic needs; they were not intended to provide opportunities for arbitrage. In fact, to permit them to be abused in that way would violate the express terms of the Act and defeat the policy goals furthered by the separate pricing methodologies that apply to resale and the unbundling of network elements.

VII. PRICING GUIDELINES FOR INTERCONNECTION MUST ENSURE THAT LOCAL EXCHANGE CARRIERS HAVE A REASONABLE OPPORTUNITY TO RECOVER THEIR COSTS.

A. The Commission Should Not Prescribe The Rates Or The Rate Structure For Interconnection Under Section 251 Of The Act

The Commission should not attempt to prescribe the rate levels or rate structure for interconnection under Section 251 of the Act.[78] Unlike Part I of Title II of the Act, Sections 251 and 252 were designed to rely primarily on the negotiation process, rather than rate of return proceedings, to set the prices for interconnection. Congress did not mistrust the negotiation process, and it empowered the State commissions and the FCC to act as arbitrators only if the negotiation process failed. If the Commission established overly restrictive rules for the pricing of interconnection, it would give the incumbent LECs and the CLECs little room to negotiate, and it would achieve by indirection exactly the result that Congress intended to foreclose when it excluded ratemaking proceedings from Section 252 of the Act.

Section 252 starts with the principle that interconnection rates should be set through "voluntary negotiations" between incumbent LECs and CLECs.[79] A binding agreement between an incumbent LEC and a CLEC does not have to conform to the requirements of subsections (b) and (c) of Section 251, and it does not have to conform to the pricing standards of

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[78] Under the title "Interconnection," Section 251 includes (1) "transport and termination" under Section 251(b)(5); (2) "interconnection . . . for the transmission and routing of telephone exchange service and exchange access" under Section 251(c)(3); (3) "network elements on an unbundled basis" under Section 251(c)(3); and (4) "resale at wholesale rates any telecommunications service that the carrier provides at retail" under Section 251(c)(4). In this section, we address the pricing principles that should apply to the first three categories.

[79] See 47 U.S.C. Section 252(a)(1).

Section 252(d).[80] Regulatory intervention only occurs if an incumbent LEC and a CLEC cannot reach a voluntary agreement. In that event, the State regulatory commission may, upon request, conduct binding arbitration of any open issues.[81] While Section 252(d) sets forth pricing principles that should guide the State commission in arbitrating an interconnection agreement, there is no provision in Section 252 for a traditional rate proceeding, and Section 252(d)(1)(A)(i) specifically states that rates for interconnection and unbundling under subsections (c)(2) and (c)(3) of Section 251 shall be determined "without reference to a rate of return or other rate-based proceeding." If the State commission fails to act, the FCC is required to "act for the State commission" -- in effect, to arbitrate an interconnection agreement as directed by the Act.[82] Any party that is dissatisfied with the results of State or federal arbitration may seek review by a Federal district court. Again, no regulatory proceeding is contemplated.

If the Commission decides, nonetheless, that it should establish guidelines for pricing of interconnection pursuant to Sections 251 and 252 of the Act, it should adopt broad guidelines that would give the parties latitude to negotiate mutually acceptable rates, terms and conditions for interconnection. In the following sections, NYNEX describes the type of pricing guidelines that the Commission could establish

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80 See id.

81 See 47 U.S.C. Sections 252(a)(2) and (b).

82 See 47 U.S.C. Section 252(e)(5).

B. The Pricing Principles Contained In The Act Were Designed To Give The Incumbent LECs A Reasonable Opportunity To Recover Their Costs

Section 251 of the Act gives the CLECs and other parties seeking to enter the local exchange market the ability to obtain the types of interconnection they need from incumbent LECs. It also guarantees that incumbent LECs will be reasonably compensated for providing such interconnection. In adopting rules to implement Section 251, the Commission should not adopt pricing principles that would deny the incumbent LECs a reasonable opportunity to recover their costs.

First, Sections 251(c)(2), (c)(3), and (c)(6) require "just, reasonable, and nondiscriminatory" rates for interconnection, unbundled access, and collocation, respectively. This language mirrors the language in Section 201(b) of the Act, which the Commission and the Courts have always interpreted to require prices that allow the LECs a reasonable opportunity to recover their actual costs of service, including a return on investment used to provide a service and a reasonable allocation of joint and common costs.[83] Second, Section 252(d)(1) states that, in determining the "just and reasonable" rate for interconnection under Section 251(c)(2), and for unbundled network elements under 251(c)(3), the State shall base its determination on "cost" plus "a reasonable profit." "Profit" is what a firm makes after it recovers its total costs of providing all of its services, including its investment-related costs.[84] A carrier cannot make a

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[83] See e.g., FPC v. Hope Natural Gas, 320 U.S. 591 (1944). The Commission's Part 69 access charge rules, which implement Section 201 of the Act, specify the direct costs, indirect costs, and return on investment that must be incorporated into a carrier's access charges. The Commission used the rates that were set under these rules as the starting point for price caps.

[84] Profit is "the excess of returns over expenditure in a transaction or series of transactions; esp.: the excess of the selling price of goods over their cost." Webster's Ninth New Collegiate